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No. 86-1038

In the Supreme Court of the United States

October Term, 1986

JAMES W. BAKER, et al.,

Appellants,

v.

CITY OF SANTA MONICA, et al.,

Appellees.

JOHN J. STEIN, et al.,

Appellants,

v.

CITY OF SANTA MONICA,

Appellee.

ON APPEAL FROM THE COURT OF APPEAL, SECOND DISTRICT OF THE STATE OF CALIFORNIA

REPLY TO MOTION TO DISMISS

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REPLY TO MOTION TO DISMISS

A.

The Instant Case Is A Price Regulation Case, Not A Land Use Case.

Following the lead of the decision of the California Court of Appeal below, Appellees have sought to characterize rent control cases as though they were land use regulation cases, with rent control legislation subject

only to the constitutional standard of not depriving the landlords' property of all reasonable use. Casting off all precedent, Appellees contend that

> . . . the law before the Court differs substantially from ordinary price regulation systems. Regulation 4100 sets limits on rent *increases*, not rents themselves. Thus, the regulation "stabilizes," rather than "sets" rents.

Motion to Dismiss at 13-14.

This, of course, is mere sophistry. The issue raised in this action is the extent to which the rent controls can deny owners a fair return. If the law does not permit the efficient owner to earn a just and reasonable return, the law is confiscatory. It matters little whether the label given to the price control law is that it "sets" prices or merely "stabilizes" prices.

Moreover, the other aspects of the rent control law (*i.e.*, the control of evictions, conversions, demolitions, habitability and other aspects of landlord-tenant relationship), except insofar as they relate to the owners' returns, are irrelevant to this action.

Until the decision of the Court of Appeal below, every court considering the constitutionality of rent control laws has considered rent control as price regulation, with the concomitant constitutional standards that such laws must permit the owners to realize a just and reasonable return. *See, e.g., Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129, 130 Cal. Rptr. 465, 550 P.2d 1001 (1976); *Fisher v. City of Berkeley,* 37 Cal. 3d 644, 209 Cal. Rptr. 682, 693 P.2d 261 (1984), *aff'd other gds,* ___ U.S. ___, 106 S.Ct. 1045, 89 L.Ed.2d 206 (1986); *Zussman v. Rent Control Board,* 371 Mass. 632, 359 N.E.2d 29 (1976); *Hutton Park Gardens v. Town Council of the Town of West Orange,* 68 N.J. 543, 350

A.2d 1 (1975); *Marshall House v. Rent Control Board,* 358 Mass. 686, 266 N.E.2d 876 (1971); *Helmsley v. Borough of Fort Lee*, 78 N.J. 20, 394 A.2d 65 (1978).

In *Bowles v. Willingham,* 321 U.S. 503, 64 S.Ct. 641, 88 L.Ed. 892 (1944), this Court noted that the federal wartime rent control laws raised the same constitutional issues as other price control legislation. In particular, the Court noted that the issue raised was the same as raised in *Yakus v. United States,* 321 U.S. 414, 64 S.Ct. 660, 88 L.Ed 834 (1944) (dismissing a challenge to other wartime price controls on the grounds that the authority given to the administrator under the act was neither unbridled nor vague and was broad enough to permit the administrator to promulgate constitutional regulations). The Court also noted,

> Congress had provided for the fixing of rates which are just and reasonable in their application to particular persons or companies. Federal Power Commission v. Hope Natural Gas Co. 320 US 591, ante, 333, 64 S.Ct. 281.

Id. at 517.[1]

The Court stopped short in *Bowles,* however, of determining the constitutional issue which is raised in the instant action.

> We need not determine what constitutional limits there are to price-fixing legislation. Congress was dealing here with conditions

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[1]In *Federal Power Commission v. Hope Natural Gas,* 320 U.S. 591, 602, 64 S.Ct. 281, 88 L.Ed. 333 (1944), the Court reiterated the constitutional test for rate setting cases stating that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks." 320 U.S. at 603.

> created by activities resulting from a great war effort. [citation omitted] A nation which can demand the lives of its men and women in the waging of that war is under no constitutional necessity of providing a system of price control on the domestic front which will assure each landlord a "fair return" on his property.

Id. at 519.

In the present case, the trial court properly applied the constitutional principles applicable to rate-setting cases and found that the returns allowed to owners — both under the Rent Control Board's old regulation (Regulation 4040) and under its new regulation (Regulation 4100)[2] — were, or necessarily would become, confiscatory.

In its decision, however, the Court of Appeal failed to apply the established constitutional test. The appellate court simply rejected the trial court's use of value (the trial court used the properties' pre-rent control values) as an element of the constitutional test and, rather than remanding the case with directions to apply some appropriate constitutional test, the court summarily upheld the rent regulation, citing only land use cases. The Court of Appeal thus failed to apply the universally accepted constitutional standard of a just and reasonable return and, instead, established new, unprecedented law. Appellants respectfully suggest that a possible resolution for this Court would be to remand the action to the Court of Appeal with the direction that it consider the owners' returns in light of the established rate-setting

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[2]The trial court found that the rent control portions of Regulation 4100, when combined with the law's prohibition against alternative uses of rental properties, were confiscatory.

principles previously enunciated by this Court.

B.

The Action Is Not Moot.

In its Motion to Dismiss, the City contends that the matter is essentially moot, since the Rent Control Board decisions that were before the trial court were based on a regulation (Regulation 4040) which has since been discarded. The City has promised that it will not resurrect that regulation again.

Of course, the City is not asserting that the entire action is moot, as Regulation 4100 and the other rent control restrictions remain in place. The case itself is therefore not moot. The City's real contention is that, since all of the decisions actually before the trial court were based on Regulation 4040, that aspect of the case is now moot and the remainder of the case is a facial attack against the newer regulation. The City apparently believes that such facial attacks are less constitutionally important.

The significance of the City's position perhaps lies in the decision of the Court of Appeal. Therein, the court discussed at length the trial court's ruling on the old regulation and overruled the trial court's consideration of value (pre-rent control value) in the constitutional test. The appellate court then upheld the old regulation, citing only land use cases. When the court finally considered the new regulation in its decision, the court skated over the critical constitutional issues, stating only that:

> "Net Operating Income" standards, such as Santa Monica's regulation 4100 et seq. (fn. 4, p. 976, *ante*) essentially a return on investment

> standard, have been approved by California courts (see *Cotati, supra,* at p. 289; *Gregory, supra,* at pp. 85-86) including the California Supreme Court in *Fisher, supra,* at pages 680-683.

181 Cal. App. 3d at 988, Jurisdictional Statement at A-21.

First, Regulation 4100 is *not* a return on investment standard and, second, the cases cited involved broadly worded ordinances and were decided on the ground that the administrator retained enough discretion to enact regulations that would provide for constitutional returns. The present case involves not a broadly worded ordinance, but a specific regulation which virtually dictates the results, leaving little or no room for discretion.

In effect, therefore, the California Court of Appeal never considered the issue of the constitutionality of the new regulation.

Of course, the significance of this action is not that a few hundred landowners are being denied a constitutional return on their properties in some California town. The significance is that the courts have utterly failed to provide these and other owners any meaningful protection of their constitutional rights. The lower courts do not even know how to determine what the owners' constitutional rights are, with the decision below being a vivid example.

C.

This Is Not A "Taking" Case.

Consistent with its previous contentions, the City asserts that, inasmuch as this case is a land use case, the Appellants are required to exhaust certain procedural remedies prior to the institution of this action. The City contends that the matter should be dismissed as it is allegedly not ripe for adjudication, citing *MacDonald, Sommer & Frates v. Yolo County,* 477 U.S. ___, 106 S.Ct. 2561, 91 L.Ed.2d 285 (1986) (rejection of a subdivision proposal) and *Williamson County Regional Planning Commission v. Hamilton Bank of Johnson City,* 473 U.S. ___, 105 S.Ct. 3108, 87 L.Ed.2d 126 (1985) (challenging certain zoning laws as applied to a residential subdivision).

Of course, rate-setting cases are not "taking" cases. Indeed, the very purpose behind the procedures for seeking mandamus or injunctive relief is to cure the defective rate-setting *before* the law effects a taking which could require compensation from the public coffers. For example, courts have held rent control laws unconstitutional not only when the returns presently allowed are confiscatory, but whenever the future returns necessarily *will be* confiscatory. Thus, while no taking may have yet occurred, a rent control law may still be declared unconstitutional as not allowing a non-confiscatory return. *Birkenfeld v. City of Berkeley, supra,* (holding the Berkeley rent control law unconstitutional on the ground that the procedures under the law would not permit the rent control board to avoid confiscatory results in the future); *Fisher v. City of Berkeley, supra* (holding that some increase ver time in nominal profits is constitutionally required. "If the net operating profit of a landlord continues to be the

identical number of dollars, there is in time a real diminution to the landlord which eventually becomes confiscatory." 37 Cal. 3d at 683 (quoting from *Cotati Alliance for Better Housing v. City of Cotati*, 148 Cal. App. 3d 280, 293, 195 Cal. Rptr. 825 (1983)).

Appellees' argument hides yet another, different tactic. By urging this and other courts only to accept individual administrative decisions rendered on individual, isolated cases, Appellees hope to avoid permanently any judicial decision on the merits. No single owner in an individual petition for rent increase could hope to afford the extent and degree of legal analysis and economic evidence that has been offered in this action. Even if some owner were to expend such funds for a constitutional test, the rent control board always has the option of completely frustrating the attempt by either granting the administrative relief requested or, if it denies the administrative relief and loses in the trial court, failing to appeal the negative decision.

D.

The Trial Court Did Not Commit Any Economic Errors.

The Motion to Dismiss contends that the trial court made an allegedly obvious error by considering only rental income in its computation of the owners' returns. Motion to Dismiss at 15-16.

This contention demonstrates a lack of understanding of the evidence and decision of the trial court. At trial, plaintiffs' experts testified that, in cases where property could virtually never be put to another use, the return realized by owners would be equivalent to the total stream of future rental income. Of course, no one owner would necessarily hold the property for that long.

However, whenever the owner sells the property, the amount realized upon sale would simply be the then-future income stream, discounted to that date. Whether one calculates internal rate of return by considering an owner's income as an infinite income stream, or as a fixed holding period plus a sales price calculated as the remaining income stream discounted to the sales date, the answer is arithmetically exactly the same. Thus, the statements set forth on pages 15 and 16 of the Motion to Dismiss are simply erroneous.

CONCLUSION

For the foregoing reasons, Appellants respectfully request this Court deny the Motion to Dismiss and note probable jurisdiction or, in the alternative, to remand the action to the California Court of Appeal with the direction that such court reconsider its opinion in light of the decisions of this Court applying constitutional principles to rate-setting cases. That these constitutional principles apply to rent control cases should be well established. How these principles apply to rent control cases is unresolved and is the issue in this action.

Respectfully submitted,

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PROOF OF SERVICE BY MAIL

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ss.

County of Los Angeles

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and a resident of the County of Los Angeles, over the age of eighteen (18) years and not a party to the within action or proceeding; that my business address is 11333 Iowa Avenue, Los Angeles, California 90025; that on February 13, 1987, I served the within *Reply to Motion to Dismiss* in said action or proceeding by depositing true copies thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed on February 13, 1987, at Los Angeles, California.

Sharon L. Stewart
(Original signed)